



## **Biweekly Narrative Seafood Report( No: 14-2001):Korea**

Prepared by Alaska State Trade Representative in Korea October, 2001

### **1. Korean Economy Update**

Economic consequences of terrorism in U.S.

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Economic & Finance Research Center, LG Economic Research Institute, Korea

The globe is jolted by the terrorist attacks on the twin towers of the World Trade Center and the Pentagon, U.S. It is very difficult to work out how long this latest shock will last or how extensive the economic consequences will be.

### **THE SHOCK TO STAY FOR SOME TIME**

However there seems to be a little likelihood of the current situation being contained and economies start functioning normally again in any near future. In whichever way this critical situation makes a turn, the world economy as well as the Korean economy will be hit with a great shock.

The potential effect of the terrorist attacks on the world economy will depend on the scale of U.S. defense against the latest events and policy cooperation between nations, and particularly on how the international financial markets would cope with this situation. It is becoming increasingly likely that the U.S. will take military action against the terrorists responsible for the attacks and those who support the offenders. However if the exact identity of the responsible party or parties remains in a haze, and thus leading to protraction of the tension in the Middle East, the international financial markets would become trapped in confusion and the U.S. economic slowdown is likely to continue next year.

### **PROLONGED RECESSION IN THE U.S.**

Although the effect of the latest terrorist attacks on the international financial markets would be limited, it would have significantly large effects on the real economies. Recently, the downside-risks mounting against the world economy have increased

considerably. And there is a big possibility of the shock of terrorism causing protraction of the current slowdown and detaining the economy from recovering.

In particular, the U.S. economy, which is contracting to a near-zero growth rate, is expected to continue struggling at least until the first half of next year. If international oil prices continue to rise while U.S. stocks weaken until the end of this year, it is highly likely that investor and consumer sentiment will dampen further.

## **SECOND HALF GROWTH RATE POSSIBLY DOWN TO 1%**

It seems inevitable that the external conditions taking a turn for the worse will also have growth-retarding effect on the Korean economy. First and foremost, Korean exports will be the hardest hit.

It had been predicted that exports would start to bottom out in the second half of the year after making the 20% fall in July and August. However, due to the terrorist attacks in the U.S., exports are now expected to get pulled down by -13.9% in the second half and -9.6% for the whole year. Consequently, the size of current account surplus is likely to shrink from \$11 billion last year to around \$9.9 billion.

The worsening of external conditions would lead to fast cooling down of consumer sentiment and also equipment investment is mostly likely to slacken even more. Consumer prices are expected to go higher than earlier forecast to around 4.3%. Due to reduction in exports and domestic demand, the GDP growth rate for the second half would only reach 1.7%, and 2.4% for the year.

The shock of terrorist attacks would continue to trouble Korean economy at least until the first half of next year. Due to the deceleration of the world economy, exports would continue to decline until the first half of next year and oil price rises would lead to increases in imports, narrowing the gap between exports and imports in the first half of 2002. The size of current account surplus is expected to get smaller than this year to \$7.5 billion in spite of the World Cup, which would boost the surplus in accounts other than trade. However as the U.S. economy starts to recover, which is expected in the second half of next year, the Korean economy is also expected to start picking up, led by exports. Next year, the economy is forecasted to post a growth rate of around 4.4%.

### Economic outlook by scenario

		Earlier forecast (Probability of 70%)		Worsening of the situation (Probability of 30%)			
		2001 2nd H Yearly		2002 Yearly	2001 2nd H Yearly		2002 Yearly
<b>World economy</b>	U.S. growth rate	0.4	1.1	1.8	-0.3	0.8	0.5
	JPY/USD (av)	120	120	118	116	118	110
	Int'l oil price(Dubai, \$/Bbl)	27	26	25	30	28	32
<b>Korean economy</b>	Eco. Growth rate	1.7	2.4	4.4	0.1	1.6	2.9
	Current account(\$bil)	3.1	9.9	7.5	0.5	7.3	2.1
	CPI	3.8	4.3	3.0	4.4	4.6	3.8
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	KRW/USD(av)	1290	1290	1270	1300	1295	1330
	Corporate bond yield(av)	6.4	6.9	7.1	6.2	6.8	6.0

### NERVOUS FINANCIAL MARKETS

Korean financial markets would move in tune with the international financial markets for the time being. As in the past, the Korean stock market is likely to weaken, in a synchronized manner, as the U.S. stock markets until the current situation begins to calm down. Furthermore, the local stock market could become subject to such adversities as flight of foreign investment funds, worsening of corporate earnings and further corporate insolvencies.

The won currency is also faced with the possibility of experiencing appreciation pressures amid strengthening of the yen. However bearish stocks, worsening of trade balance, delay in economic recovery and poor foreign investment into Korea are all factors that would weaken the won currency. Hence, even if the won comes under appreciation pressures, the extent of appreciation would only be limited. However one cannot rule out the possibility of the won depreciating if the adverse effects on the Korean economy magnify and the yen does not appreciate as much.

The anticipation of economic contraction in the world and Korean economy is likely to lead to a fall in bond rates. The monetary authority is expected to manage a flexible monetary policy through expansion of money supply and interest rate reduction and prevent further contraction of the economy. Despite rises in the international oil prices, there would not be much inflationary pressures amid the economic slowdown.

Due to the inclination for 'flight to quality' and the stock market plunges, companies would have difficulty of raising funds in the money market. In particular, if the gloomy outlook for the Korean as well as the world economy spreads, investors would avoid buying bonds with a credit rating below BBB. The outcome of this would mean a double-edged sword of slower sales and difficulty in financing for companies with low credit ratings, which in turn could be linked to more corporate bankruptcies.

## **WAR & CONFUSION**

We cannot eliminate the possibility of the current crisis leading to a full-blown war in the Middle East as the U.S. have made clear its firm stance against terrorism. And if the recent terrorist attacks turn out to have been supported systematically at a national level, the country(ies) would also become the subject of retaliation by the U.S. That could mean more terrorist acts in the U.S., leading to deeper and prolonged confusion in the international affairs.

Protraction of this critical situation could instigate capital outflow from the U.S. through impairing of creditworthiness of the U.S. economy and weakening of the position of the dollar. And if high oil prices provide no room for financial easing, then the effect on international financial markets would be less than predictable. Possibly, plunges in stock prices and bonds as well as in the value of the dollar, all of which is caused by capital outflow from U.S., would create linkages of a vicious cycle through which capital outflow increases even more.

In such a case, the U.S. economy's growth rate for next year could fall short of 1%. As the recession in the U.S. drags on, Europe, currently under great pressures of an economic downturn, Japan, Southeast Asia and South America would also be dragged down with it. A slowdown in the world economy would bring about a vicious cycle that deepens U.S. export and economic sluggishness, only to throw the world economy into a more severe recession.

Moreover, the effects on Korean economy will grow more destructive. As the phenomenon of flight to quality becomes prevalent, there may occur a massive outflow of capital from the Korean money market and as stock prices fall, the real economy could plunge into a more serious downturn. It is possible that the interest rates will fall by a large extent in response to economic downturn, but the won currency, despite strengthening of the yen, may become subject to depreciation pressures due to worsening of the trade balance and stagnant inflow of investment capital.

A dull world economy would lead to greater falls in exports while oil price rises would push up imports, causing a sharp deterioration in current account after the second half of this year. Due to oil price hikes, inflationary pressures are expected to build up and as consumer and investor sentiment weakens further, the economic growth rate for the second half is expected to drop to 0.1% level while that for the whole year would be just around 1% level. If the confusion in international affairs continues and/or the slowdown in the world economy protracts, next year's economic growth rate would drop below 3%.

## **ECONOMIC PLAN FOR THE WORST**

The Korean government needs to become more ardent in securing stability of the macro economy. It is true that the government has less policy options now that there is the possibility of price rise amid the worsening of the external circumstances. However it needs to take into consideration of even the worst scenario and, if necessary, would need

to expand budget outlays and make additional interest rate cuts. Foremost, the government is required to make efforts as to prevent financial markets from panicking over overreaction of economic participants.

In order to prevent corporate activity from contracting, the government would need to provide ample liquidity in the money market, and make efforts to keep won exchange rate stable in light of growing fluctuations of the international exchange rates.

*(Source: September 20, 2001, LG Economic Research Institute, Korea)*

## **2. What's New in Korea**

### **1) South Korea warns of damage to ties with Russia, Japan over fishing dispute**

South Korea warned yesterday that the moves by Japan and Russia to deny Korea's fishing rights in the waters near the disputed Southern Kuril islands will seriously damage Seoul's relations with both nations.

Foreign Minister Han Seung-soo summoned Japanese and Russian ambassadors to protest a proposed Tokyo-Moscow agreement whereby Russia will reportedly ban South Korea and other nations from fishing in the area.

"It is very disappointing and regrettable that Russia and Japan are heading for the agreement which will seriously hurt the South Korean fishing industry," Han told Russian Ambassador Teymuraz O. Ramishvili.

Han also told Japanese Ambassador Terusuke Terada that he is deeply concerned that the accord will further damage the bilateral relations between South Korea and Japan, which are already soured due to historical issues.

Han's complaint is the strongest that the Seoul government has lodged over the issue thus far.

Japan and Russia are reportedly close to an accord on banning South Korea and other nations from fishing around the islands off northern Japan beginning next year.

The two nations are currently negotiating Japan's compensation for economic losses that Russia will suffer for denying other nations' operations in the waters, Japanese news media has reported.

The agreement is expected to be signed during the Asia-Pacific Economic Cooperation (APEC) summit to be held in Shanghai Oct. 20-21.

He also called for Russia to take into consideration Korea's position and maintain consultation with Seoul so that the issue won't strain the friendly ties between the two nations, he aides said.

The Russian envoy was quoted as replying that the agreement has not been finalized and needs more work on details.

The summoning of envoys, the second this week, followed Han's telephone conversation with his Japanese counterpart Makiko Tanaka late Thursday.

He delivered Korea's position that Seoul and Tokyo should make efforts to work out an amicable solution through high-level negotiations and the planned summit between President Kim Dae-jung and Prime Minister Junichiro Koizumi, a Foreign Ministry official said.

Tanaka said that she understands South Korea's concerns well and the agreement has not been finalized yet. But she added that Japan is giving priority to the territorial issue involving the "Northern Territories," as the Southern Kuril is called in Japan.

*(Source: October 13, 2001, the Korea Herald, Seoul, Korea )*

### 3. Statistical Data: Harvest Trend of Korea's Deep-Sea Fishing

(Unit: ton)

<b>Species</b>	<b>Jan.-Aug., 2001(A)</b>	<b>Jan.-Aug., 2000(B)</b>	<b>A/B(%)</b>
Alaska Pollock	<b>90,876</b>	<b>37,172</b>	<b>244</b>
Tuna	<b>159,668</b>	<b>143,578</b>	<b>111</b>
Squid	<b>143,003</b>	<b>171,473</b>	<b>83</b>
Saury	<b>9,531</b>	<b>7,160</b>	<b>133</b>
Others	<b>75,521</b>	<b>99,928</b>	<b>76</b>
Total	<b>478,599</b>	<b>459,311</b>	<b>104</b>

*(Source: September 17, 2001, the Korea Fisheries Times, Seoul, Korea)*